88-392

Supreme Court, U.S.
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NO.

in the

Supreme Court

of the

United States

OCTOBER TERM, 1988

W. MONROE STEPHENSON
Petitioner

VERSUS

PAINE, WEBBER, JACKSON & CURTIS, INC.
AND
JAMES E. WELCH

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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ATTORNEY FOR PETITIONER

QUESTIONS PRESENTED

1. Whether the Court of Appeals for the Fifth Circuit erred in refusing to consider the District Court's failure to disclose grounds for disqualification pursuant to 28 U.S.C. §455(a).

2. Whether the Court of Appeals for the Fifth Circuit erred in applying a due diligence recklessness defense to defeat petitioner's claims under §10(b) and Rule 10b-5.

3. Whether the Court of Appeals for the Fifth Circuit and the District Court failed to consider petitioner's claims under §12 of the 1933 Act, or alternatively, whether said courts erred in subjecting §12 claims to a due diligence recklessness defense.

LIST OF PARTIES

In accordance with Supreme Court Rule 1.1(b), petitioner submits the following ist of all parties to the proceeding in the nited States Court of Appeals for the Fifth ircuit, whose judgment is sought to be eviewed. The parties are, to-wit:

. List of Petitioner

1. W. Monroe Stephenson

. List of All Other Parties

2. Paine, Webber, Jackson & Curtis, Inc.

3. James E. Welch

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NO.

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The petitioner, W. Monroe Stephenson, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered on March 15, 1988, as well as the rehearing opinion of the United States Court of Appeals for the Fifth Circuit entered on June 7, 1988.

OPINIONS BELOW

The original panel opinion of the United States Court of Appeals for the Fifth Circuit is reported at 839 F.2d 1095. (Appendix A). Petitioners' Petition for Rehearing was denied on June 7, 1988. (Appendix B). The opinion of the District Court for the Eastern

District of Louisiana is not reported. (Appendix C).

JURISDICTION

The judgment of the United States Court of Appeals for the Fifth Circuit was entered on March 15, 1988. A petition for rehearing was filed and denied on June 7, 1988. The jurisdiction of this Honorable Court is invoked under 28 U.S.C. §1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. 28 U.S.C. §455 states, in relevant part:

> "(a) Any justice, judge, or magistrate of the United States shall disqualify himself in any proceeding in which his partiality might be questioned.
>
> * * *
>
> (e) No justice, judge, or magistrate shall accept from the parties to the proceeding a waiver of any ground for disqualification enumerated in subsection (b). Where the ground for disqualification arises only under subsection (a), waiver

may be accepted provided it is preceded by a full disclosure on the record of the basis for disqualification."

2. Section 10(b), 15 U.S.C. §78j(b), of the Securities and Exchange Act of 1934 provides, as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or the mails, or of any facility of any national securities exchange-

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security no so listed, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

3. SEC Rule 10b-5, 17 C.F.R. §240.10b-5 (1984) provides, as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

4. Section 12(2), 15 U.S.C. § 771(2), of the Securities Act of 1933 provides, in relevant part:

"Any person who...
(2) offers or sells a security...by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him..."

STATEMENT OF THE CASE

Petitioner, W. MONROE STEPHENSON, [hereinafter referred to as "STEPHENSON"], brought suit against his former broker, JAMES E. WELCH, [hereinafter referred to as "WELCH"], and against the broker's employer, PAINE, WEBBER, JACKSON, CURTIS, INC., [hereinafter referred to as "PAINE, WEBBER"], to recover for unauthorized trading losses which occured in STEPHENSON's account at PAINE, WEBBER. The District Court granted PAINE, WEBBER's motions for involuntary dismissal pursuant to Rule 41(b).

The panel of the Fifth Circuit Court of Appeals affirmed the District Court, dismissing petitioner's claims under Rule 10b-5 on the grounds of recklessness. On rehearing, the panel addressed petitioner's claims under §12 of the 1933 Act and affirmed the District Court's dismissal of same.

In late 1982 through mid-1983, WELCH systematically purchased option calls in

STEPHENSON'S account all without his knowledge or authorization. Most of these unauthorized trades took place in the summer of 1983, and particularly when plaintiff was on vacation. Immediate complaints thereafter to WELCH [who was assistant branch manager at the time] were met with repeated assurances that the transactions were made without authorization and that he would make good any losses incurred.

PAINE, WEBBER documentation verified the pattern of switching of trades from one account into another. This information was readily available to PAINE, WEBBER and could have prevented unauthorized trading had it exercised proper supervision over WELCH.

REASONS FOR GRANTING THE PETITION

The Fifth Circuit has decided a federal question in a manner which conflicts with the decisions of this Court. Supreme Court Rule 17.1(c).

I. THE DISTRICT COURT COMMITTED REVERSIBLE ERROR IN FAILING TO INFORM PETITIONER OF AN ATTORNEY/CLIENT RELATIONSHIP WITH DEFENSE COUNSEL WHICH WOULD HAVE WARRANTED RECUSAL.

The panel improperly refrained from passing on the merits of this claim on the basis of waiver. See, 839 F.2d 1095, 1096, n.3.

Such action was in derogation of the express wording of the recusal statute which specifically provides that grounds for disqualification may be waived by a party provided it is preceded by full disclosure on the record by the district judge. In this instance there was no disclosure whatsoever made by the judge and a denial of any basis for recusal by defense counsel. Therefore, recusal could not have been waived by petitioner.

This is not a situation like Delesdernier v. Porterie, 666 F.2d 116 (5th

Cir. 1982), cert. denied, 459 U.S. 839 (1982). Instead, armed with but a rumor, defense counsel of immense respect was approached. His denial of any basis for recusal was clear and unequivocal. Weighing rumor against clear denial, no further thought was given the matter.

It was not until many months after the trial and during the pendency of this appeal that counsel learned in conversation with attorneys associated with the Coca-Cola case [which occured at the same time as did this case] that Judge Feldman had specifically informed all counsel of an attorney/client relationship with PAINE, WEBBER's counsel. He offered to recuse himself if so asked in that matter.

Judge Feldman confirmed this fact with petitioner's counsel during the week before the appeal brief was filed. He explained that upon his recent appointment to the federal bench, respondent's counsel had

represented him on matters involving his former law firm and additionally that PAINE, WEBBER's counsel was the attorney for his estate in his will. He further explained that he had made these disclosures in other instances involving respondent's counsel in order to avoid the appearance of impropriety.

Unfortunately, through some oversight, in this action, no such disclosure was given. Had the disclosure been made, recusal would certainly have been sought, especially since the action had been transferred to Judge Feldman after recusal at plaintiff's request by Judge Carr.

In Delesdernier, supra, Judge Rubin gave a full and detailed disclosure on the record of what he perceived as a potential conflict. Neither party sought recusal once fully informed. Accordingly, their informed consent constituted waiver.

In contrast, in this action there was no such disclosure made or sought because of the

adamant denial of defense counsel that no such relationship had ever existed.

This action is similar to the posture of Potashnik v. Port City Construction Co., 609 F.2d 1101 (5th Cir.), cert. denied, 449 U.S. 820 (1980), wherein the grounds for recusal under Section 455(a) were not discovered until after trial had been concluded. Such grounds were not here known to STEPHENSON until after the appeal was perfected. Since the district court is divested of jurisdiction once an appeal is lodged, STEPHENSON'S only recourse was to assert the recusal grounds on appeal. The Fifth Circuit should have remanded for an evidentiary hearing if it felt the record lacking in details of grounds for recusal.

> "Scienter is not an element of a violation of §455(a). The judge's lack of knowledge of a disqualifying circumstance may bear on the question of remedy, but it does not eliminate the risk that "his impartiality might reasonably be questioned" by other persons."

Liljeberg v. Health Services Acquisition Corp., ___ U.S. ___, 108 S. Ct. 2194, 2204 (1988).

The very fact that the District Judge felt compelled to offer recusal in other actions with respondent's counsel tried at the same time as this case indicates the District Judge's concerns--concerns which should have formed a basis for disclosure and recusal if requested. Judge Feldman's disclosure in those other matters was in keeping with the spirit and purpose of the recusal statute.

Accordingly, remand for determination of potential recusal should be ordered as was done in Health Services Acquisition Corp. v. Liljeberg, 796 F.2d 796 (5th Cir. 1986); or, alternatively, remand for new trial should be ordered.

> "We conclude that in determining whether a judgment should be vacated for a violation of §455, it is appropriate to consider the risk of injustice to the parties in the

> particular case, the risk that the denial of relief will produce injustice in other cases, and the risk of undermining the public's confidence in the judicial process."

Liljeberg, supra, ___U.S.___, 108 S.Ct. at p. 2204.

II. THE PANEL IMPROPERLY APPLIED THE DEFENSE OF DUE DILIGENCE IN LIGHT OF THE SUPREME COURT HOLDING IN BATEMAN EICHLER.

In light of Ernst & Ernst v. Hochfelder, 425 U. S. 185 (1976), many circuits, including the Fifth Circuit felt it necessary to re-evaluate their "due diligence" defense standards in 10b-5 actions, §78(j). See, Dupuy v. Dupuy, 551 F.2d 1005 (5th Cir. 1977), cert. denied, 434 U.S. 911 (1977).

> "The Court should take this opportunity to clarify the standard of care expected of plaintiffs in litigation under Rule 10b-5. Business can be transacted more freely and efficiently if the responsibility for verifying underlying facts is clearly allocated. Because securities litigation can be complex and expensive,

> it should be avoided to the maximum extent by early clarification of the ground rules."

434 U.S. at p. 912.

This Court has now reviewed Rule 10b-5 actions and defenses where "damages [are sought to] be barred on the grounds of the plaintiff's own culpability." Dahl v. Pinter, 787 F.2d 985, 989 (5th Cir. 1986), rehearing denied, 794 F.2d 1016, vacated and remanded, ___U.S.____, 56 L.W. 4579 (1988), citing, Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U. S. 1 (1985). Of course, the defense herein has been that STEPHENSON'S own conduct in failing to root out the truth bars his recovery. The District Court and the Fifth Circuit both accepted this proposition.

Those decisions are in direct conflict with Bateman Eichler and Dahl v. Pinter.

Bateman Eichler abolished the defenses of estoppel, ratification, waiver, and laches, specifically holding that in a Rule

10b-5 action the in pari delicto defense would bar the plaintiff's recovery only when:

> "(1) As a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and
> (2) Preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investment public."

472 U.S. at p. 11.

Pinter v. Dahl, ___ U.S. ___, 56 L.W. 4579 (1988) further clarified Bateman Eichler:

> "We do not share the Court of Appeals' narrow vision of the applicability of Bateman Eichler. Nothing in this Court's opinion in that case suggests that the in pari delicto defense is limited to §10(b) claims. Nor does the opinion suggest that the doctrine applies only when the plaintiff's fault is intentional or willful.
>
> * * *
>
> ...Thus, we conclude that Bateman Eichler provides the appropriate test for allowance of the in pari delicto defense in a private action under any of the federal securities laws."

___ U.S. ___, ___, 56 L.W. 4582, 4583.

STEPHENSON'S claims under Rule 10b-5 should be governed by that same standard and not by the recklessness standard stated by the panel.

In both Bateman Eichler and Dahl, the plaintiffs were actively at fault in creating or participating in the illegal act which gave rise to ultimate liability. Yet, in each instance the plaintiff was permitted to recover since his actions were not of equal fault to that of the broker.

In contrast, in the present action STEPHENSON is faulted for not policing his broker closely enough to prevent fraudulent and unauthorized transactions from occuring in his account. Knowledge of a single unauthorized trade and the broker's dilatory correction of same must somehow bar STEPHENSON's recovery for later unknown unauthorized trades, opined the Fifth Circuit. This Court's opinion states otherwise:

> "Unless the degrees of fault are essentially indistinguishable or the plaintiff's responsibility is clearly greater, the in pari delicto defense should not be allowed, and the plaintiff should be compensated."

Pinter v. Dahl, ___ U.S. ___, at p. ___, 56 L.W. 4579, at p. 4583.

Thus, the pivotal question becomes: May a securities broker who violates the provisions of Rule 10b-5 totally escape liability to his client because of the failure of the client to police the actions of the broker?

Other equally appropriate questions would seem: Is it logical to prohibit recovery by a party who failed to discover illegal actions of his broker while at the same time permitting recovery by a party who knowingly participated in an illegal scheme with his broker? Is not the plaintiff more at fault in the second instance? Could one seriously argue that one who participates in an illegal scheme has not acted with "due diligence" in

the handling of his affairs? Since both actions arise under the same statutory authority, i.e. § 10(b), Rule 10b-5, and §12, should not the result be the same?

STEPHENSON has asserted valid claims under both Rule 10b-5 and §12 [15 U.S.C. §77(1)] of the 1933 Act. The intended purpose behind each provision is "protection of the investing public and the national economy through the promotion of high standards of business ethics...in every facet of the securities industry." Bateman Eichler at p. 15, citing, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-87 (1963); Dupuy v. Dupuy, 551 F.2d 1005, 1019 (5th Cir. 1977), cert. denied, 434 U.S. 911 (1977). The purpose is not to impose policing obligations on the plaintiff as the Fifth Circuit panel so held. As this Court noted in Liljeberg, busy schedules of professionals in the legal field may impair their devoting full attention to their personal matters.

> "When a busy federal judge concentrates his or her full attention on a pending case, personal concerns are easily forgotten."

___ U.S. ___ at p. ___, 108 S.Ct. 2194 at p. 2204 (1988).

The panel ruled that because STEPHENSON had not monitored WELCH closely enough, he should be foreclosed from recovering not only the losses which he should have discovered in a timely fashion, but also those unauthorized trading losses which he did in fact timely discover and bring to the attention of PAINE, WEBBER.

In essence the panel noted three occurrences in late 1982 and early 1983 which should have alerted STEPHENSON to the fact that WELCH did not intend to correct the one known unauthorized trade and the discrepancy in interest earned versus interest charged on the GNMA bonds. Later unauthorized trades occured in STEPHENSON'S account largely in late May, June, July, and early August, 1983.

STEPHENSON undeniably became aware of these trades upon his return from vacation on or about 8 August 1983. He immediately complained to the assistant branch manager (WELCH) and in fact followed up his friend's failure to act with three demand letters which PAINE, WEBBER received in September, 1983. Certainly these actions of complaining were neither "reckless" nor in pari delicto with WELCH.

To deny these later unauthorized trades merely because STEPHENSON knew or should have known that WELCH had made improper trades in the past places an undue burden on STEPHENSON to monitor and police the activities of his fiduciary agent. Romano, infra. It was PAINE, WEBBER and not STEPHENSON who bore that responsibility. Bateman Eichler; Dupuy v. Dupuy, supra. PAINE, WEBBER had failed in its duty to properly monitor the activities of WELCH. 839 F.2d 1095, 1097 (5th Cir. 1988).

Clearly, under any standard, denial of the later discovered unauthorized trading would "significantly interfere with the effective enforcement of the securities laws and protection of the investment public." Bateman Eichler, 472 U.S. at p. 11.

Further support for these propositions may be found in the decisions of other circuits. In Holdsworth v. Strong, 545 F.2d 687 (10th Cir. 1976), cert. denied, 440 U.S. 955 (1976), the Court there stated:

> "Thus, where there has been intentional misrepresentation the common law does not exact a duty of due care or due diligence from the injured plaintiff.
>
> * * *
>
> Just as contributory negligence is not a defense to an intentional tort case of fraud, similarly due diligence is totally inapposite in the context of intentional conduct required to be proved under Rule 10b-5."

545 F.2d at p. 694. Accord, Sunstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033 (7th Cir. 1977), cert. denied, 434 U.S. 875

(1977); Straub v. Vaisman, 540 F.2d 591 (3rd Cir. 1976).

> "[B]etter reasoned cases have rejected contributory negligence as a defense applicable to intentional deceit." Prosser, Handbook of the Law of Torts, §108, 4th Ed. (1971).

Since Rule 10b-5 actions require a showing of scienter they are by their very nature actions involving intentional deceit.

The Seventh Circuit has followed this same approach in disavowing the due diligence concept. Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522 (7th Cir. 1985).

> "Neither this nor (to our knowledge) any other appellate court has relieved a lying securities defendant of liability on the ground that the other party failed to nose out the truth."

With regard to a Rule 10b-5 action, the plaintiff bears the burden of proving not mere negligence but scienter, i.e., intent to deceive, manipulate, or defraud or severe recklessness (unreasonable omissions or

misrepresentations). Shivangi v. Dean Witter Reynolds, Inc., 825 F.2d 885 (5th Cir. 1987).

This increased burden of proof justifies the removal of common law defenses and the imposition of the in pari delicto analysis to determine first if the defendant has been guilty of fraud or deceit, and second, whether the plaintiff's actions were just as culpable as the defendant.

In an action such as this, denial of the claim of innocent parties would frustrate the intended purpose of the act-- the protection of the investing public.

> "It is therefore fair to say that the federal policy of deterring intentional misconduct in securities dealings outweighs the policy of deterring negligent behavior by investors.
> This argument leads to the conclusion that nothing in the Act requires disregard for the comparative equities of the parties. If it is fairer for a judicially allocated loss to fall upon the more culpable actor under tort law, the judicially created remedial system for the Securities Acts can respond to similar notions of

> equity without disrupting the legislative scheme."

Dupuy v. Dupuy, 551 F.2d 1005, 1019 (5th Cir. 1977), cert. denied, 434 U.S. 911 (1977).

Practical and policy considerations do not justify imposition of a recklessness defense where a fiduciary relationship exists. Romano v. Merrill, Lynch, Pierce, Fenner & Smith, 834 F.2d 523 (5th Cir. 1987). Caveat emptor no longer reigns. By permitting private causes of action in this area, public policy notions are fostered in requiring high ethical business standards of securities brokers and dealers. Extending Bateman Eichler beyond the tipper/tippee situation preserves that aim.

> "Thus it is particularly important to permit 'litigation among guilty parties [that will serve] to expose their unlawful conduct and render them more easily subject to appropriate civil, administrative, and criminal penalties. Perma Life Mufflers, Inc. v. International Parts Corp., 352 U.S. 134, 138-39 (1968)."

Kuehnert v. Texstar Corp., 412 F.2d 700, 705 (5th Cir. 1969), cited with approval by Bateman Eichler, supra, at p. 15 n. 27.

Thus, the obvious and only logical reading of Bateman Eichler demonstrates the evolution and justifiable erosion of the affirmative defenses asserted herein. The guilty party should, in equity and in law, be held responsible for his actions.

III. THE PANEL OF THIS COURT FAILED TO PROPERLY CONSIDER PLAINTIFF'S CLAIMS UNDER §12 OF THE 1933 ACT.

Liability of WELCH and PAINE, WEBBER may be found at §77(1) of the 1933 Act.

STEPHENSON maintains that he was totally unaware of any of the trades discussed herein. However, even assuming that WELCH did in some fashion mention or discuss some of the trades with STEPHENSON, WELCH'S failure to disclose material information

constituted a violation of §12. That is, even assuming WELCH'S version of the facts to be true, liability is still founded under §12.

Petitioner has throughout this litigation alleged several violations of §77(1):

(1) The offer to sell the GNMA bonds was made with a material misrepresentation that the rate of interest earned on the securities would exceed the rate of interest charged in the margin account by 3 percent.

(2) WELCH under instructions from PAINE, WEBBER'S branch office manager placed virtually worthless options in STEPHENSON'S account without informing him of the following material facts:

(a) the options were only worth a fraction of the original purchase value;

(b) the options were cancellations from other customers accounts; and

(c) WELCH was obligated to absorb the losses unless he found an account into which the options could be placed.

These trades of Commodore International Calls (Transactions 51, 52, 53, and 54) totalled in excess of $30,000.00. By the time they were manipulated into STEPHENSON'S account [the office manager approved the account transfer], they had a value of approximately $4,000.00, and by WELCH'S own admission, nothing could be done to lessen their eventual worthless expiration. Tr. Vol. III, p. 52. These four trades along with transactions 48, 49, and 50 which appeared in STEPHENSON account in August, although ostensibly entered in June, all expired worthless with a total loss of approximately $44,500.00. Joint Stipulation.

(3) The scheme of unauthorized trading of options in STEPHENSON'S account was the gravest of "[omissions] to state a material fact".

Most of these unauthorized transfers were confirmed by the Holland-Sipes audit memo (see, Motion to Submit Newly Discovered Evidence) which PAINE, WEBBER failed to produce during discovery despite its control by the PAINE, WEBBER compliance department.

That document's existence was first disclosed in the companion litigation involving the numerous other complaining customers and was produced to petitioner once this matter was well within the appellate process. Accordingly, the District Court was never afforded an opportunity to review same or to hear testimony concerning this audit of the accounts of WELCH.

Even despite this crucial evidence, it was demonstrated at trial, as follows:

(i) There were no order tickets of any nature for transactions 3, 11, 12, 13, or 14. Tr. Vol. I, pp. 94-97 and Tr. Vol. II, pp. 152-56.

WELCH did not inform STEPHENSON that these trades would be journalized into his account.

(ii) The order tickets for transactions 4, 24, 31, 35, 36, 40, 48, 51, 53, and 54 all contained either an account number other than STEPHENSON'S, or a client name other than STEPHENSON. Tr. Vol. III, pp. 38-52 and Exhibit P-14. The clients who appeared on these order tickets (Vickie Carleton, secretary to WELCH'S counsel, Curtis Kennedy, Gail Ruddock, Harold McDaniel) were all customers of WELCH who complained of unauthorized trading in their accounts.

WELCH failed to inform STEPHENSON that these trades had been intended for other client accounts and in fact initially placed in other client accounts.

(iii) PAINE, WEBBER reported to the Options Clearing Corporation that transations 3, 11, 12, 13, 14, 15, 31,

36, 40, 46, 47, 49, 51, 52, 53, 54, and 57 were intended for client accounts other than STEPHENSON. These clients (Bob Gilbert, Harold McDaniel, Jon Massey, Curtis Kennedy, Vickie Carleton, Gail Ruddock, Henry Fry, Gus Andros, and Manual Novoa), all of whom complained of unauthorized trading by WELCH, are identified at Exhibit P-24. Tr. Vol. I, p. 147; Tr. Vol. (unnumbered), pp. 61-64.

Again, WELCH failed to inform STEPHENSON that these trades were purchased for other client accounts. Transfer into STEPHENSON'S account was an after-the-fact event.

(iv) STEPHENSON was out of state or out of the United States during the period of time when many trades took place, and during that period of time there was no communication between himself and WELCH.

Since there was no communication between WELCH and STEPHENSON during the time the following trades took place, certainly material facts such as time, price, value,

and risk (all material to an informed trade) were not made.

The undisputed testimony at trial revealed that there were no informed discussions on these topics. Thus, transactions 25, 27, 30, 32, 35, and 37 all resulted from omissions of material facts. See, Tr. Vol. III, pp. 177-180.

Since recklessness in any form is not a defense to §12 claims, Dahl v. Pinter, 787 F.2d 985 (5th Cir. 1986); Junker v. Crory, 650 F.2d 1349, 1361 (5th Cir. 1971); Sanders v. John Nuveen & Co., Inc., 619 F.2d 1222 (7th Cir. 1980), cert. denied, 450 U.S. 1005 (1981); and since neither WELCH nor PAINE, WEBBER met their affirmative burden of proving lack of culpability, the District Court's carte blanche dismissal of the §12 claims was in error. Tr. Vol. IV, 63-64. The Fifth Circuit likewise failed to adequately consider these claims under §12.

The District Court failed to consider these claims in light of §12, and only briefly discussed §12 claims in ruling on statute of limitations. See, Appendix C at pp. C-60-61.

Thus, the District Court either failed to properly consider these claims concerning material misrepresentations, or labored under the legal misconception that such claims were subject to a due diligence defense. The panel on rehearing summarily affirmed, also without noting the substantive difference between material misrepresentations or omissions on the one hand and unauthorized trading on the other. See, Appendix B at pp. B-33-34.

Unquestionably, §12(2) claims under the 1933 Act are not barred by a failure to exercise due care. Therefore, the District Court's denial was unjustified even on a "recklessness" standard.

Even assuming STEPHENSON received and reviewed the confirmation slips with the information contained therein, such confirmation slips did not contain the material information of (1) differential in value versus cost [Tr. Vol. II, pp. 53,54, 237-38], (2) transfer from other clients' accounts [Tr. Vol. II, pp56-57], or (3) WELCH'S personal liability for the erroneous trades if not absorbed by STEPHENSON [Tr. Vol. II, pp. 60,61]. Thus, by the very admissions of WELCH and PAINE, WEBBER, liability should be imposed under §12.

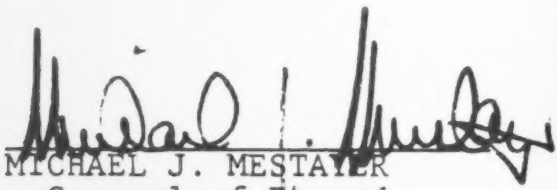
WELCH and PAINE, WEBBER both admitted that there was no control or supervision over WELCH insofar as these allegations were concerned, and that had such supervision taken place, the pattern and scheme of unauthorized trading would have been evident. In fact, the panel found as much. See, 839 F.2d at p. 1097.

By WELCH'S own admissions there was ample evidence of violations of §12 and no evidence of exculpatory conduct of WELCH or PAINE, WEBBER.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,



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APPENDIX A

W. Monroe STEPHENSON,
Plaintiff-Appellant,

versus

PAINE WEBBER JACKSON & CURTIS,
INC. and James E. Welch,
Defendants-Appellees.

No. 86-3515.

United States Court of Appeals,
Fifth Circuit.

March 15, 1988.

Investor brought suit against brokerage and broker for trading securities on his behalf without authorization. The United States District Court for the Eastern District of Louisiana, Martin L.C. Feldman, J., dismissed the suit, and plaintiff appealed. The Court of Appeals, Edith H. Jones, Circuit Judge, held that: (1) sophisticated investor's delay in reporting allegedly unlawful trades and his failure to read correspondence from brokerage containing accurate and detailed information about his accounts, even after he became fully aware that the account

were not being properly handled, rose to the level of recklessness, precluding his Rule 10b-5 claim; (2) there is no private cause of action under § 17(a) of the Securities Act of 1933; and (3) the Louisiana Unfair Trade Practices Act does not apply to securities fraud cases.

Affirmed.

1. Securities Regulation 60.18, 60.48(1)

In order to demonstrate a violation of Rule 10b-5, plaintiff must prove: a material misrepresentation or omission by defendant; scienter on part of defendant; reliance; and due diligence by plaintiff to pursue his or her interest with care and good faith. Securities Exchange Act of 1934, Sec 10(b), 15 U.S.C.A. § 78j(b).

2. Securities Regulation 60.48(1)

Sophisticated investor's delay in reporting allegedly unlawful trades and his failure to read correspondence from brokerage

containing accurate and detailed information about his accounts, even after he became fully aware that such accounts were not being properly handled, rose above mere negligence to the level of recklessness, precluding his Rule 10b-5 claim against broker and brokerage. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. Sec. 78j(b).

3. Securities Regulation 27.27

There is no implied private cause of action under § 17(a) of the Securities Act of 1933. Securities Act of 1933, § 17(a), 15 U.S.C.A. § 77q(a).

4. Trade Regulation 862.1

The Louisiana Unfair Trade Practices Act is not applicable to securities fraud cases. LSA-R.S. 51:1401 et seq.

Michael J. Mestayer, New Orleans, La., for plaintiff-appellant.

Phillip A. Wittmann, Stephen H. Kupperman, George C. Freeman, III, New Orleans, La., for Paine, et al.

Robert J. Fineran, Mandeville, La., for Welch.

Appeal from the United States District Court for the Eastern District of Louisiana.

Before WISDOM, GARWOOD, and JONES, Circuit Judges.

EDITH H. JONES, Circuit Judge:

In May 1984, Monroe Stephenson brought suit against Paine, Webber, Jackson & Curtis, Inc. ("Paine Webber"), and James Welch ("Welch"), a former Paine Webber broker, for trading securities on his behalf without authorization, which he alleged constituted a violation of the Securities Act of 1933, 15 U.S.C. § 77a, et seq.; the Securities Exchange Act of 1934, 15 U.S.C. § 78a, et seq.[1]; the Racketeer Influenced and Corrupt Organizations ACt ("RICO"): 18 U.S.C. § 1961, et seq.; and state law.[2] The district

court dismissed the § 17(a), RICO, and state law claims as a matter of law pursuant to Fed.R.Civ.P. 12(b)(6), and dismissed the 10b-5 claim pursuant to Fed.R.Civ.P. 41(b) after finding that plaintiff had not carried his burden of proof and that the claim was otherwise barred by equitable defenses. On appeal, Stephenson challenges the district court's rulings as to all counts of the complaint and raises for the first time an alleged conflict of interest between the trial judge and defendant's counsel which, Stephenson submits, warrants recusal of the trial judge and a new trial.[3] We affirm the district court's judgement.

I.

BACKGROUND

In 1979, Stephenson, a tax attorney, opened several accounts in New Orleans with Paine Webber and shortly thereafter began trading in options with the assistance of James Sanders, a Paine Webber account executive. When, in early 1982, Sanders left Paine Webber, Stephenson's account was transferred to Welch, another broker in the local Paine Webber office. Stephenson resumed options trading through Welch and continued such trading until late 1983. After each trade in his account, Stephenson received a confirmation slip for the transaction from Paine Webber, and for each month there was activity in his account, he received a monthly account statement which

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1. Specifically, the complaint implicates Rule 10b-5, 17 C.F.R. 240.10b-5 (1976) promulgated under § 10(b) of the 1934 Act, 15 U.S.C.A. § 78j(b) (1976).

2. Plaintiff also alleged violations of the Commodity Exchange Act, but that claim was later abandoned.

provided detailed information about that activity, including the amount of each trade, the identity of each item traded, whether the trade was in a margin account, and the rate of interest charged on the margin account.

In October 1982, Stephenson was informed by telegram that he owed over $4,000 for a trade made on his behalf by Welch in September. According to Stephenson, that trade was clearly unauthorized, but he challenged only Welch, and not Paine Webber, about it. Welch allegedly promised to correct the error but failed in the following months to do so.

Stephenson ignored his December 1982

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3. We refrain from passing on the merits of plaintiff's assertion, raised for the first time on appeal, that the district judge and Paine Webber's counsel had an attorney-client relationship which would have warranted the judge's recusal. Plaintiff has waived any objection by not raising it at an earlier stage of the litigation. See Delesdenier v. Porterie, 666 F.2d 116, 121-23 (5th Cir. 1982), cert. denied, 459 U.S. 839, 103 S.Ct. 86, 74 L.Ed.2d 81 (1982).

monthly statement from Paine Webber, looking only at the interest figure for his tax return. He did nothing at this point to see whether the purportedly improper trade of September 1982 had been corrected. Had he done so, he would have been alerted to what he now asserts were other unauthorized trades. Stephenson was aware in January 1983, however, that he had not received a promised positive interest spread on GNMA margin purchases.

In April 1983, Stephenson was informed by Welch that alleged errors in his account had not been corrected and in June, he received a mailgram confirming a bond purchase that he asserts was not authorized. Again, Stephenson complained only to Welch, and not to Paine Webber, of the "mistake." Nevertheless, Stephenson's account remained active and numerous trades were executed on STephenson's behalf from May-August 1983, the period during which Stephenson's greatest

losses were incurred. Stephenson admitted at trial, however, that he never opened a single confirmation slip or account statement until August of 1983 because, as he testified, he regarded them as "junk mail."

Not until August 24, 1983 did Stephenson issue his first formal written complaint, in the form of a letter hand-delivered to Welch regarding the handling of his account. The letter objected to only eleven (11) transactions, all of which had been made subsequent to June 21, 1983.

On August 31, 1983, Stephenson wrote a second letter similar to the first which was also hand-delivered to Welch. Finally, on September 15, Stephenson wrote a third letter which identified fifty-nine (59)[4] allegedly unauthorized transactions in his account. Each of these transactions had been reported in account statements and in been reported in account statements and in confirmation slips transmitted to Stephenson between August 9,

1982 and August 1983. Paine Webber was not aware of Stephenson's allegations until it received this third letter dated September 15, 1983.[5]

At trial, evidence was introduced to show that Paine Webber had not exercised sufficient supervision over Welch and that had it done so, the unauthorized transactions would have been brought to the attention of Paine Webber at a much earlier date so that further unlawful trading could have been prevented.

The district court concluded that Stephenson had failed to carry his burden of establishing the alleged violations of Rule 10b-5 by a preponderance of the evidence. In so finding, the court determined that in light of Stephenson's extensive financial training and experience,[6] his failure to take corrective action upon learning that his broker had made an error constituted reckless conduct. The court also relied on its

observation of Stephenson's testimony as "simply not believable."

The court further held that Stephenson's securities claim was barred by the equitable defenses of laches, waiver, and ratification. Stephenson's disregard of the confirmation slips and monthly statements was found to constitute waiver of his right to sue for the allegedly unauthorized transactions, and it was held that his delay of at least eleven months in complaining of Welch's conduct [from October 1982 to September 1983] resulted in prejudice to Paine Webber and Welch so as to invoke the defense of laches.[7]

II.

ANALYSIS

A. The 10b-5 claim

At the close of appellant's case, the trial court dismissed his 10b-5 claim

pursuant to Rule 41(b) of the Federal Rules of Civil Procedure. In reviewing a Rule 41(b) dismissal, "the district court's conclusions of law are subject to de novo review, but we may not disturb its findings of fact unless they are clearly erroneous." Crisis Transp. Co. v. M/V Erlangen Exp., 794 F.2d 185, 187 n. 5 (5th Cir.1986). Accordingly, our scope of review of the district court's factual findings and weighing of the evidence is narrow.[8]

[1] In order to demonstrate a violation of Rule 10b-5, the plaintiff must prove (1) a material misrepresentation or omission by the defendant, (2) scienter on the part of the

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4. By the time of trial, the list of allegedly unauthorized transactions had grown to 67.

5. Welch was thereafter suspended from his position at Paine Webber for unauthorized trading.

defendant, (3) reliance, and (4) due diligence by the plaintiff to pursue his or her own interest with care and good faith. Dupuy v. Dupuy, 551 F.2d 1005, 1014 (5th Cir.1977) cert. denied, 434 U.S. 911, 98 S.Ct. 312 54 L.Ed.2d 197 (1977). Our analysis in this case focuses on the due diligence element of the claim.

Prior to the Supreme Court's holding in Ernst and Ernst v. Hochfelder, 425 U.S. 185, 96 S.Ct. 2194, 48 L.Ed.2d 811 (1976), many courts adopted a negligence standard in determing whether a plaintiff's duty of due diligence had been met. See, e.g. Clement A.

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6. Stephenson has business and law degrees, is an expert in federal income tax law, is intimately familiar with current account techniques, has been legal counsel in several securities fraud cases, and has been trading securities in the stock market since 1962.

7. The district court also found that Paine Webber's supervision of Welch, while perhaps sloppy or casual, was not unreasonable, and therefore not actionable.

Evans & Co. v. McAlpine, 434 F.2d 100, 103 (5th Cir.1970); City National BAnk of Fort SMith Ark. v. Vanderboom, 422 F.2d 221, 230 (8th Cir.1970), cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560 (1970). In Ernst, the Supreme Court held that mere negligence on the part of a defendant cannot satisfy the scienter requirement for liability under 10b-5. This ruling prompted several circuit courts to reevaluate the appropriateness of a negligence standard in the due diligence context in view of the fact that negligence had been held inadequate to satisfy the defendant's intent requirement. The Fifth Circuit undertook this task in Dupuy, 551 F.2d 1005, and held that after Ernst, the relevant inquiry in determining due diligence is whether the plaintiff has "internationally refused to investigate in disregard of a risk known to him or so obvious that he must be taken to have been aware of it, and so great as to make it

highly probable that harm would follow." Dupuy, 551 F.2d 1005 at 1020 (citing W. Prosser, § 34 at 185 (1971)). This "recklessness" standard has been followed without exception in the Fifth Circuit.[9]

Stephenson principally contends that the Supreme Court's decision in Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 105 S.Ct. 2622, 86 L.Ed.2d 215 (1985) essentially abolished the due diligence requirement for private 10b-5 actions as well as the equitable defenses of estoppel, waiver, and ratification. Without citing any apposite language from BAteman Eichler, appellant asserts that because Bateman Eichler narrowed the availability of the in pari delicto defense in securities fraud cases brought by tippees, it correlatively expanded the scope of all private 10b-5 causes of action. We disagree.

Bateman Eichler neither discussed the elements of the plaintiff's cause of actions

under Rule 10b-5 (as it assumed they existed in the case) nor suggested that its principles govern any other equitable defenses than in pari delicto.[10] In the absence of support from the holding or even dictum of Bateman Eichler, Stephenson must rely solely on analogy to defeat the requirement of a plaintiff's diligence and the possibility of other equitable defenses. His analogy, founded on general references to the deterrent aspects of the federal securities laws, fails.

Although due diligence, equitable defenses and the in pari delicto doctrine are arguably related in that they inquire into a plaintiff's conduct, they are applied in decidedly different contexts. The doctrine of due diligence and equitable defenses, like waiver, laches, estoppel or ratification, require an investor to be attentive to self-protection, whereas in pari delicto applied where the plaintiff has failed in his

duty of disclosure to others, e.g., where a tippee trades on the basis of inside information without disclosing that information. Bateman Eichler's holding results from the concern that insider trading may go largely undiscovered by law enforcement officials if tippees are altogether precluded by in pari delicto from bringing suit against tippers. Thus, Bateman Eichler specifically limits its holding regarding the inapplicability of the in pari delicto defense to situations where preclusion of suit would interfere with enforcement of the securities laws. See Bateman Eichler, 472 U.S. at 310, 105 S.Ct. at 2629, 86 L.Ed.2d at 224.

The due diligence standard and the equitable defenses, contrary to Stephenson's reasoning, ultimately foster the same law enforcement goal as Bateman Eichler, but from a different perspective. We have rightly stated, "by requiring plaintiffs to invest carefully, the Court promotes the anti-fraud

policies of the Acts and engenders stability in the markets." Dupuy, 551 F.2d at 1014. These standards relating to a plaintiff's conduct encourage an investor to complain promptly about violations of his or her rights, and in so doing, to enable those with authority to control wrongdoing before additional investors are injured. The SEC has from its inception encouraged diligence in stock transactions. Straub v. Vaisman & Co., 540 F.2d 591, 597 (3d Cir.1976); see also Wheeler, Plaintiff's Duty of Due Care under Rule 10b-5: AN Implied Defense to an Implied Remedy, 70 Nw.U.L.Rev. 561, 564-68 (1976). To eliminate diligence-promoting standards in private Rule 10b-5 causes of action by a false analogy with Bateman Eichler, would seriously undercut the objectives of the SEC and the securities law. Bateman Eichler does not eliminate the existing due diligence requirements nor does

it contravene our continued recognition of the equitable defenses in Rule 10b-5 cases.[11]

[2] This case demonstrates the wisdom of retaining the recklessness-due diligence standard for plaintiffs. Although it is not clear that Stephenson challenges the district court's finding of his recklessness, the district court's finding was not clearly erroneous.[12] We agree with the district court that Stephenson's delay in reporting the allegedly unlawful trades and his failure to read Paine WEbber correspondence containing accurate and detailed information about his accounts, even after he became fully aware that those accounts were not being properly handled, rose above mere negligence to the level of education, experience, and demonstrated prowess in financial and securities matters are a critical factor in our decision. Stephenson is well-versed in securities transactions. He has traded securities with personal funds for over

twenty years, has participated in securities fraud litigation, and has had wide exposure to investment issues in his capacity as a tax attorney. Further, Stephenson had ample opportunity to attempt to rectify the alleged errors in his account. It was uncontroverted at trial that he knew of an "unauthorized" transaction in October 1982, that he knew it had not yet been corrected in April, 1983, and that an interest spread promised for Spring 1983 had not materialized. Throughout the entire period of alleged unauthorized trades, he received statements which he knew would have revealed the status of his accounts. He never read them. This is not a case in which an unsophisticated or trusting investor relied upon a broker's superior expertise or a close friend's accommodation. Compare Petrites, 646 F.2d 1033; Dupuy, 551 F.2d 1005; Siebel, 725 F.2d 995. Stephenson was sufficiently knowledgeable and in control of his affairs to have reviewed his Paine

Webber statements, as most people do their monthly bank statements, and discern a pattern of error.

These facts, together with the district court's expressed doubt about Stephenson's creditibility at trial, are sufficient to support its findings of recklessness.[14]

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8. North Mississippi Communications, Inc. v. Jones, 792 F.2d 1330, 1333 (5th Cir.1986); Hersch v. United States, 719 F.2d 873, 876-77 (6th Cir.1983); 9 C. Wright & A. Miller, Federal Practice & Procedure § 2376 at 248 (1971).

9. See, e.g. Siebel v. Scott, 725 F.2d 995 (5th Cir.1984), cert. denied, 467 U.S. 1242, 104 S.Ct. 3515, 82 L.Ed.2d 823 (1984); Petrites v. J.C. Bradford & Co., 646 F.2d 1033 (5th Cir.1981); G.A. Thompson & Co. v. Partridge, 636 F.2d 945 (5th Cir.1981); Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111 (5th Cir.1980); Dupuy v. Dupuy, 551 F.2d 1005 (5th Cir.), cert. denied, 434 U.S. 911, 98 S.Ct. 312, 54 L.Ed.2d 197 (1977).

10. We acknowledge that as a consequence of Bateman Eichler, it might be logically inconsistent for a court to bar the action of a plaintiff tippee, who knowingly received undisclosed material

inside information, against his tipper on grounds of waiver, estoppel, or ratification. We express no opinion, however, on whether this necessarily or always follows from Bateman Eichler because that case, as the Court acknowledged, was disposed of on the pleadings and without the development of a record or other issues. In any event, such logic would not undermine the affirmative defense in other sorts of cases, like this one, where the plaintiff did not participate in any securities law violation.

11. James v. Meinke, 778 F.2d 200 (5th Cir.1985), post-dates Bateman Eichler and does not suggest that the Supreme Court there modified the plaintiff's due diligence requirement for recovery; Dahl v. Pinter, 787 F.2d 985, 988 (5th Cir.1986), cert. granted, ---U.S.---, 107 S.Ct. 1885, 95 L.Ed.2d 493 (1987), discusses the defense of equitable estoppel in tandem with in pari delicto, implying that estoppel remains a valid defense after Bateman Eichler.

12. This Court held that a number of factors may be used to gauge whether a plaintiff's conduct indicates a lack of due diligence amounting to recklessness so as to bar recovery, including: "existence of a fiduciary relationship, concealment of the fraud, opportunity for detection, [plaintiff's] position in the industry, sophistication and expertise in the financial community ...knowledge of related proceedings...[and] whether the plaintiff initiated the transaction or pressured for a speedy resolution." G.A.

B. The § 17(a) Claim.

[3] Appellant next urges that this court recognize the existence of a private remedy under § 17(a) of the Securities Act of 1933.[15] While the Supreme Court has declined to express any view as to the availability of such an action,[16] the issue was addressed by this court at length in Landry v. All American Assurance Co., 688 F.2d 381, 384-91 (5th Cir.1982), which held that § 17(a) of the Federal Securities Act of 1933 does not create an implied private cause of action. Thompson & Co. v. Partridge, 636 F.2d 945, 955 (5th Cir.1981).

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13. Because we affirm the trial court's Rule 41(b) disposition of plaintiff's claim, it is not necessary to analyze the apparent challenge by Stephenson to the court's alternative findings on the affirmative defenses raised by appellees.

14. In Romano v. Merrill Lynch, Pierce, Fenner & Smith, 834 F.2d 523, 528 (5th Cir. 1987), the Fifth Circuit recently noted the existence of authority stating that the receipt of confirmation slips, standing alone, does not provide suffi-

Landry was cited with approval in Keys v. Wolfe, 709 F.2d 413, 416 (5th Cir.1983) and has not been criticized or challenged in any subsequent opinion of this Court. We see no reason to question its propriety, and therefore affirm the district court's dismissal of the § 17(a) claim.

C. The RICO Claim.

Appellant's contention regarding his RICO claim is likewise without merit. It is well settled in the Fifth Circuit that there must be a distinction between the RICO "person" and the RICO "enterprise."[17] Appellant failed to establish this distinction in his pleadings and at trial, and his RICO claim was therefore properly dismissed.

D. The State Law Claims.

[4] Appellant next challenges the district court's Rule 12(b)(6) dismissal of his claim brought under the Louisiana Unfair Trade Practices Act[18], La.R.S. 51:1401 et seq. (LUTPA). In holding this statute

inapplicable to securities fraud cases, the district court relied on Moore v. A.G. Edwards & Sons, Inc. 631 F.Supp. 138 (E.D. La.1986), the only case which has squarely addressed the issue.[19] We, like the Moore court, find persuasive the Fourth Circuit's analysis of a similar statute in Lindner v. Durham, 761 F.2d 162 (4th Cir.1985), and after examining the Act's legislative history and other state-provided remedies for securities fraud, we conclude that the statute is inapplicable in the present context.

The language of the statute is extremely broad and would seem at first glance to cover the type of situation presented here. Within its definition of unfair trade practices the act specifically includes "unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce", La.R.S. 51:1405(A), and leaves the determination of such unfair trade practices

to a case-by-case analysis. However, several factors militate against allowing recovery under the act in securities fraud cases. First, we note that treble damages are available under the LUTPA but not under Louisiana's Blue Sky Law. Had the Louisiana legislature intended the availability of treble damages in securities fraud cases, it would either have provided for such a remedy in its Blue Sky Law, or somehow indicated that the LUTPA was broad enough to cover securities violations.

Second, 1405(A) of LUTPA is patterned after, and nearly identical to, § 5(a) of the

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cient notice of "churning" (trading in a client's account to generate commissions without regard to the client's interests). The panel, however, refrained from passing on this issue and went on to find that the claimant had been adequately apprised of the churning violations. The court emphasized the need to consider each case on its own facts, and stressed that the claimant's high level of sophistication was a strong factor in its decision. Id. at 528. Our opinion here is not inconsistent with Romano.

Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) (1982). Louisiana courts have found appropriate the use of federal decisions interpreting § 5 of the FTC Act in interpreting § 1405(A). See, e.g., Guste v. Demars, 330 So.2d 123, 125 (La.App.1976). The FTC Act has been interpreted to preclude coverage of securities claims. Third, it appears that allowing securities actions under the act is inconsistent with the state statutory scheme for remedying securities violations in that it would create a functional overlap between the Governor's Consumer Protection Agency, which carries out investigative and enforcement duties under the Unfair Trade Practice Act, and the state banking commissioner whose responsibilities include enforcing the Blue Sky Law. Thus, we reject Stephenson's LUTPA claim.

The district court dismissed Stephenson's claim for emotional distress on the grounds that Louisiana law requires a

non-pecuniary interest as the case for emotional distress, and no such interest was present in this case. Because a district court is in a better position than are we to ascertain the law of the state in which it sits, see infra n. 18, we defer to its determination of Louisiana law on this issue, nothing that the emotional distress claim also fails because plaintiff has not succeeded in demonstrating that any trades were "unauthorized" as that term is legally defined.

For the foregoing reasons, the judgement of the district court is AFFIRMED.

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15. 15 U.S.C. § 77q(a) (1976).

16. See Bateman Eichler at 472 U.S. 303 n. 6, 105 S.Ct.2625 n. 6.

17. Bishop v. Corbitt Marine Ways, Inc., 802 F.2d 122, 122-23 (5th Cir.1986).

18. The Louisiana Unfair Trade Practices Act provide in pertinent part:
Unfair methods of competition and unfair or deceptive acts or practices in the

conduct of any trade or commerce are hereby declared unlawful.
La.R.S. 51:140(A)

19. Because no Louisiana court has settled this issue decisively, we must determine what the Louisiana courts would decide if confronted with this question. In such a situation, we accord substantial deference to the district court's determination of the law of the state in which it sits. Edwards v. State Farm Ins. Co., 833 F.2d 535, (5th Cir.1987).

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 86-3515

W. MONROE STEPHENSON,
Plaintiff-Appellant,

versus

PAINE, WEBBER, JACKSON & CURTIS, INC.
AND
JAMES E. WELCH,
Defendants-Appellees.

Appeal From The United States District Court
For the Eastern District of Louisiana

Petition For Panel Rehearing
(Opinion March 15, 1988, 5th Cir. 1988 839 F.2d 1095)

(June 7, 1988)

Before WISDOM, GARWOOD, AND JONES:

EDITH H. JONES, Circuit Judge:

Appellant Stephenson petitioned for panel rehearing of our decision affirming the district court's dismissals of his securities fraud claims. Stephenson v. Paine Webber

Jackson & Curtis, Inc., 839 F.2d 1095 (5th Cir.. 1988). The only significant contention he makes in his petition is that the panel failed to consider his claim brought under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77(1) (2).

In a § 12(2) action, the plaintiff bears the burden of proving, inter alia, that material misstatement or omission was made by the seller in connection with an offer or sale of securities. Hill York Cop. v. American Int'l Franchises, Inc., 448 F.2d 680, 695-96 (5th Cir. 1971). As best we can tell, Stephen asserted that the same facts giving rise to violations of Rule 10(b)-5 also underpin his § 12(2) claim. The district court dismissed all of Stephenson's claims, including the § 12(2) claim, pursuant to Federal Rule of Civil Procedure 41(b) after finding that Stephenson had not carried his burden of establishing unlawful trades as to <u>any</u> of the claims. In affirming the

district court's dismissal, we stated unambiguously that "plaintiff has not succeeded in demonstrating that any trades were 'unauthorized' as that term is legally defined." 839 F.2d at 1101 (emphasis added). Thus, although the § 12 claim was not separately analyzed in the panel's opinion, it was properly considered and resolved under this general finding.

There is no merit in the remainder of the petition for rehearing, consequently,

Appellants' petition for panel rehearing is DENIED.

APPENDIX C

THE COURT: The motion to dismiss is granted. The Court finds that, upon the facts and the law, the plaintiff has shown no right to relief. The Court has heard all of the testimony, had an opportunity to observe and make judgments against the credibility of the witnesses, has painstakingly -- both with and without counsel -- reviewed the extensive documentation which has been shared with he Court and is in the record, and weighing and evaluating the evidence, as the Court must do under Rule 41(b), it is the Court's decision that the plaintiff has shown, upon the facts of the law, no right to relief and make the following findings of fact and conclusions of law.

Monroe Stephenson has sued Paine Webber and a former Paine Webber broker, Mr. Welch, alleging violations of the Securities Act of 1933, the Securities Exchange Act of 1934, the RICO statute and pendant questions under state law pertaining to the negligence of Mr.

Welch and Paine Webber. His complaint was also brought under the provisions of the Commodities Exchange Act, but that claim was abandoned.

The Court has previously dismissed, as a matter of law, the claim under the Louisiana Unfair Trade Practices Act, has held that the claim under Section 17(a) of the 1933 Securities Act is not well taken because Section 17(a) does not provide for a private right of action, has dismissed the RICO Claims to Paine Webber because Paine Webber may not be both enterprise and person; and during the trial, after hearing the evidence, has dismissed the claim for emotional distress on the grounds that Article 1998 of the Louisiana Civil Code requires a non-pecuniary interest as the case for the comfort in question, and that the interest implicit in this case was clearly a pecuniary one, and on the grounds that although the Court does recognize that claims for emotional distress

are available in the case of wrongful conversion of one's property, as demonstrated by the Quealy case cited by the plaintiff, this is not a claim for wrongful conversion and factually the Quealy case is distinguishable and inapplicable from this case.

Mr. Stephenson began investing casually in securities in the stock market nearly twenty-five years ago. On or about September 19, 1979, he opened a new account with the defendant, Paine Webber, and shortly thereafter, under unclear circumstances, a client option agreement and qualification form was also a matter of record at Paine Webber. Mr. Stephenson traded at times in covered optioned. His original broker, Mr. James Sanders, testified that he explained the risk of option trading to Mr. Stephenson before any option trades were made, and indeed the new account form listed a variety of unranked objectives of which speculation was one, which is thoroughly consistent with the

indication in the new account form that both option and commodity trading might be conducted.

Mr. Sanders, in fact, testified that Mr. Stephenson was approved for all option trading and that Mr. Sanders told Mr. Stephenson to be certain to check his confirmation slips and call him at once in the event of a problem. Mr. Sanders left Paine Webber, and in March of 1982 Mr. Stephenson's account was transferred to the defendant, Mr. Welch.

Naked optioned trading through Mr. Welch continued in Mr. Stephenson's account until late 1983, and in fact Mr. Stephenson had traded naked options in Avon on the recommendation of Mr. Sanders early on in his relationship with Paine Webber. And in that one trade alone Mr. Stephenson's investment was at risk for some two months.

During the time that Mr. Welch was his stockbroker, Mr. Stephenson was in touch with

Mr. Welch either at lunch or on the telephone or periodic visits to one another's office concerning their personal relationship as well as the business relationship that they enjoyed.

Although Mr. Stephenson now claims that some sixty-seven trades in options were unauthorized, it is beyond serious dispute that immediately after each order was entered in Mr. Stephenson's account, Paine Webber mailed Mr. Stephenson a confirmation of each specific transaction. The confirmations set out all appropriate and necessary disclosure information concerning the transaction, including the transaction ate (sic), including the specifics of the type and quantity of the security purchased, the purchase or trade price, and whether the trade was made in a market (sic) account. Nothing was hidden by Paine Webber, and there is no evidence that Welch ever got Paine Webber not to disclose

certain order of trades in Mr. Stephenson's account.

Mr. Stephenson admits that Paine Webber mailed the confirmations to him and that he recognized the confirmation slips in the envelops (sic) that they came in when they were received. Indeed, Mr. Stephenson also admitted that Paine Webber's monthly statements were regularly sent. And he further, candidly and somewhat surprisingly, admitted that he simply considered Paine Webber material in the nature of junk mail. He gave the material to his secretary, who put it in the out box to later be filed, unopened.

That testimony is somewhat curious in view of the piece of testimony by Mr. Sanders, which the Court must note parenthetically; Mr. Sanders testified that when he became Mr. Stephenson's stockbroker, Mr. Stephenson tended to deal in cash only and bought stocks not on margin but for cash. Mr. Sanders could not testify that Mr.

Stephenson did or did not open his confirmation slips, but Mr. Sanders did indeed testify that Mr. Stephenson always paid for his stocks and he never had any trouble getting the money that was due Paine Webber, which presumably came from confirmation slips opened by Mr. Stephenson.

Mr. Stephenson also admits, as I've indicated that he received from Paine Webber a monthly statements also provided detailed information of every transaction in the account for the current statement period. They told Mr. Stephenson each position in each security that he held at the end of the statement period, indicated trades being made in his margin account, indicated margin account balances and interest charges. Mr. Stephenson says that he treated this information like his bank account, that he reviewed nothing until year end. He said he did that because his account was inactive and there was no need to review Paine Webber's mailings

which, again, he characterized as "junk mail".

The evidence betrays any idea that the plaintiff had any reason whatsoever to believe that his account was an inactive account. The mailings at times from Paine WEbber regularly exceeded ten pieces a month, a strange statistic for what one characterized as an "inactive account." By reviewing each statement upon receipt, Mr. Stephenson cold not only confirm what trades were made for his account within the statement period but also could confirm the accuracy of the summary of the positions in his account, the propriety of the trades in his account, and the extent of interest charged in his margin.

The evidence is hopelessly in conflict as to whether Stephenson was aware of and authorized any or every trade made in his account before it was made or whether he was aware of and authorized every trade in his

account before the closing date of the trade. The Court believes that no one has been completely candid and forthcoming in their testimony, but what is clear is that Mr. Stephenson had knowledge of the trades in his account during 1982; and in any event, regardless of any conflict in the testimony, clearly had actual knowledge not later than the time at which he prepared his 1982 income tax returns of the potential for unauthorized trades by Mr. Welch in Mr. Stephenson's account.

In October, 1982 Mr. Stephenson got a margin call, as the Court recalls, for something in excess of $40,000 by way of a telegram dealing with a trade of the calls of Phelps Dodge, which took place on September 3, 1982. That trade, according to Mr. Stephenson, was clearly unauthorized. He challenged Mr. Welch about the trade, but he didn't challenge Paine Webber. According to Mr. Stephenson, Mr. Welch said that he would

fix things, but Mr. Stephenson also said that Mr. Welch did nothing more for the next two or three months. Mr. Welch simply did not perform as he had promised, according to Mr. Stephenson's testimony, and Mr. Stephenson knew or should have known that something was amiss if his testimony is to be believed.

In December of 1982, in the face of that knowledge and information, knowing that Mr. Welch apparently had not yet confirmed that something had been corrected, in the face of being told that he owes a company in excess of $40,000 for something he didn't buy or authorize, as he alleges, Mr. Stephenson ignored his December 1982 monthly statement from Paine Webber, merely looked at the last of the three pages to get the interest figure for his tax return and did absolutely nothing to check to see whether or not the unauthorized trade in Phelps Dodge in September of 1982 had been corrected. Had he done so, he certainly would have been alerted to what

he now claims were other unauthorized trades. Thus far, nearly one year from at least October 1982 through August 1983 the plaintiff, knowing of uncorrected and unauthorized trades in Phelps Dodge as early as September 1982, did nothing to stop what he claimed was happening.

There is evidence from some notes on some confirmation slips that indeed, as Paine Webber and Mr. Welch contend, Mr. Stephenson may well have been riding the market to chance his profits. Mr. Stephenson's first written complaint occurred August 24th in a letter to James Welch, a letter which did not mention any alleged unauthorized or otherwise unacceptable transactions occurring prior to June 21, 1983, although the letter did refer to error transactions. The only transactions the plaintiff complained of in the letter were recent Commodore option trades and cash fund transactions.

It is the second letter, the letter of August 31, 1983, which suggests that the post August 8th trades were also unauthorized, but that letter tends to suggest that perhaps the trades may have been known to Mr. Stephenson, that is, the post August 8th, 1983 trades.

Mr. Stephenson's account of what happened is unconvincing and at times approaches the inappropriately casual and probably the bizarre. Several weeks later, on September 15th, Mr. Stephenson produced a list of some fifty-nine unauthorized transactions that he claimed had occurred in his account, including post August 8, 1983 transactions, which other evidence would suggest Mr. Stephenson was aware of, certainly should have been aware of had he reviewed his statements transmitted to Mr. Stephenson between August 9, 1982 and August 22, 1983.

Paine Webber was not aware of Stephenson's allegations until September 15, 1983. Should they have been more cautious in

their supervision of Mr. Welch? Except for the transaction in 1981 in which Mr. Schultz was notified about an unauthorized stock sale, not an option sale, by Mr. Welch in another customer's account, the Court can't say that Paine Webber has acted unreasonably. Perhaps sloppily, perhaps too casually, considering the nature of their business, but not unreasonably in terms of their obligation to supervise Mr. Welch. And I agree with counsel for Paine Webber that one isolated incident in 1981, not indicating any pattern of impropriety, would not be enough to put, in the Court's view, Paine Webber on notice. In fact, Mr. Schultz immediately discussed Mr. Stephenson's problems when he became aware of them upon receipt of the September 15th letter.

Mr. Welch's conduct in this entire unpleasant episode appears to clearly have been questionable in many instances and, as I've indicated, Paine Webber's monitoring

internally could possibly have been better. But whether or not it rises to the level of culpability for anything that Mr. Welch may have done is something the Court believes is not demonstrated by a preponderance of the evidence, considering the evidence that is before the Court. Paine Webber hid nothing from the plaintiff. That is an undeniable fact. Plaintiff's damages could have and should have been stopped as of October 1982 had he acted to correct and insure that the Phelps Dodge trade was being corrected.

The law does teach that the test of recklessness is to be applied in a subjective manner. The Court has done so. This is a very difficult decision for the Court to make, but the Court must abide by the Court's own instructions to juries at the close of the cases when juries are admonished not to be swayed by sympathy, prejudice or passion for one or the other of the parties.

Mr. Stephenson is a lawyer of nearly thirty years, and the Court has been personally familiar with Mr. Stephenson and his practice for that entire length of time. Mr. Stephenson is a noted preparer of tax returns. Mr. Stephenson's well known business practice in the community may not be understated. As some of the exhibits indicated, he has participated extensively in business litigation. He has represented business clients, including stockbrokers. He is familiar, at least, certainly with stock fraud litigation and securities litigation; whether as co-counsel or lead counsel makes no difference.

As of October 1982 he knew of a blatant unauthorized trade, according to his testimony. In December 1982 he knew of an alleged discrepancy between margin account interest charged and interest earned on GNMA bonds.

The Court finds Mr. Stephenson's explanation of his conduct simply not believable,

even assuming that Mr. Welch may have acted inappropriately, although I want to stress that evidence of that is in conflict and unclear. What do the subjective measures of Mr. Stephenson suggest in terms of whether his conduct was reckless or not? The incident of October 1982, namely the margin call and Mr. Stephenson's explanation that, notwithstanding, thereafter he did not open his mail, which would have put him on guard. The Southwest Harris County bond trade in June 1983 should have reaffirmed the discomfort that Mr. Stephenson should have experienced in October 1982. The interest dispute in December 1982 between margin interest and bond interest earned should have said to one not acting recklessly, particularly one familiar with business and taxes and the law, that something ought to be done, something might be amiss, perhaps I should be more careful.

Although Mr. Stephenson claims that he was out of town substantially between March and August 1983, that is a flimsy excuse. He was, by his own testimony, here in New Orleans at least a minimum of eleven weeks during that period of time and still his mail went unopened, long after his suspicions should have been alerted, as I've indicated and need not detail again. Mr. Stephenson does not deny that the mail kept coming. He admitted not opening his mail for some eleven months, in spite of being alerted to Mr. Welch's alleged mischief.

His testimony about what he did is suspect and is suspect in material respects. For example, what he did with the December 31, 1982 monthly statement, after knowing of the unauthorized Phelps Dodge trade, is suspect. The fact that he didn't ask Paine Webber to get rid of Mr. Welch is suspect. Where Mr. Stephenson got the critical 1982 tax information reflecting trades which he

now claims were unauthorized is suspect in terms of his testimony.

Jurisdiction of this Court is founded under the Securities Act of 19833, the Securities Exchange ACt of 1934, Racketeering Influenced and Corrupt Organizations Act and pendant jurisdiction under state law claims. The Court finds that the defenses of laches, acquiesence and ratification are all applicable to bar, as harsh as that seems, the plaintiff from his claims. They are based on equitable concepts which must be applied by the Court, the equitable concept that one with actual or constructive knowledge of a wrongdoing must be prohibited from standing idly by, taking no corrective action, and then attempting to benefit one way or the other from profit or loss by seeking damages.

Once an investor, most particularly an investor of the background and training and discipline and experience of Mr. Stephenson, discovers that an error has been made by his

broker, in this case with accusation that the error amounts to an unauthorized and inappropriate action, with respect to one's account and one's fiduciary responsibilities, he can't ride the market, seek to take the gains and hope he doesn't get any losses. If the conduct rises to the level of recklessness, the Court is aware and stresses that negligence is not enough under the law. That is clearly the teaching of Royal Air Properties, Inc. v. Smith, decided by the Ninth Circuit in 1962.

Waiver requires that there must be an intentional relinquishment of a known right. Another Ninth Circuit case teaches us that, Hecht v. Haris, Upham & Company. Of special note is the Fifth Circuit decision in 1981 of Patrites v. Bradford, in which the plaintiff was an inexperienced nd unsophisticated investor, and the Court would not apply the recklessness defense. But the principles of Patrites apply here, and they must be applied

to defeat the plaintiff because he was highly knowledgeable, as I've indicated, and he should have conducted himself in a far different manner.

The plaintiff's complaints must be rejected based upon his admitted receipt of confirmation slips and monthly statements. He clearly waived his right to sue for unauthorized trades when he failed to complain about the alleged trades upon receipt of his confirmations and monthly statements, at least as of October 1982.

The Court finds that although Mr. Welch's conduct can at best be viewed as suspicious, Paine Webber hid nothing. The testimony and evidence about whether Mr. Welch actually acted in an unauthorized manner is clouded with doubt and uncertainty and really inconclusive.

What is not inconclusive, regrettably, is that Mr. Stephenson acted bizarrely. He acted recklessly within the meaning of the

law. To invoke the doctrine of laches, again, there must be a lack of diligence by the plaintiff and prejudice to a defendant, as taught by Hecht and Castille against the United States, a Supreme Court decision rendered in 1961.

Mr. Stephenson failed to complain for at least eleven months after the first alleged unauthorized transaction, after not opening his mail and after not examining his confirmation slips and monthly statements. Assuming that the transactions about which he complains were unauthorized, his lack of diligence in reading his statements and in promptly complaining to Paine Webber has certainly resulted in substantial prejudice to Paine Webber and, in a curious way, to Mr. Welch.

A timely complaint would have brought the matter to Paine Webber's attention. The suspicious actions of Mr. Welch, if indeed they merit suspicion and further action,

could have been discovered, supervised, corrected. Mr. Welch could have been counselled. But of course we can't speculate about that because no complaint was made to Paine Webber. Certainly one would have expected, if a complaint had been made, that unauthorized trading, if it had been occurring, would have stopped.

Rather than complaining about sixty-seven transactions, Mr. Stephenson, in an ironic twist, would have only had to complain of one. Through his own lack of diligence, with a clear genesis in plaintiff's own reckless conduct, which plaintiff himself admitted to the Court was dumb, plaintiff now seeks to place Paine Webber at risk for those sixty-seven trades, despite the fact that it was solely within his power, by the simple exercise of care, by the placing of a telephone call, by the writing of the September 15, letter eleven months earlier to limit his own risk, not to mention

Paine Webber's and Mr. Welch's to the risk of one trade of ten calls of Phelps Dodge. But he permitted a continuous course of conduct of which he now complains, and the doctrine of laches unqualifiedly is applicable to prevent plaintiff's recovery even against Mr. Welch.

Ratification also applies. Ratification is essentially a simply theory of the law of agency in which one being a principal adopt the previous action performed by one's agent made in the principal's name, here Mr. Stephenson. The doctrine of ratification, as it is applicable here, is rooted soundly in the second restatement of agency in Section 82 in the Ocrant decision decided by the Tenth Circuit in 1974, in the Jaksich decision decided by the Southern District of New York, and especially compelling to this Court is Ferguson v. Francis I. dupont & Co, decided by the Northern District of Texas in 1974.

Mr. Stephenson claims that Mr. Welch entered transactions in his account without authorization, but he admits that he (sic) material which Paine Webber sent would have fully disclosed everything. Upon receipt he had the choice to read the material and act upon it, read it and not act on it or not read it. He chose the latter. Having made the decision, he cannot now be heard to complain. He has ratified or acquiesced in every alleged unauthorized transaction. Without adequately pursuing his complaint against Mr. Welch, he continued doing business with the defendants, by his own admission, as to the GNMA bonds for nearly a year after the initial transaction which he now asserts was improper. He cannot lose his innocence and the law must not allow him to lose his innocence. His conduct is viewed by Court as reckless and exceeding even Mr. Welch's alleged conduct, deficient as it seems to this court.

Damages in a Rule 10(b) (5) case are limited by what the plaintiff would have realized if he had acted to preserve his assets when he first learned or when he first should have learned of a problem. That is the unqualified teaching of Harrington v. Merrill Lynch, another Ninth Circuit case. I hope the Fifth Circuit excuses me for citing so many Ninth Circuit cases. Also a Tenth Circuit decision. I'm sorry.

Harrington clearly teaches that a plaintiff simply cannot recover that part of a loss which is caused by his own failure once the plaintiff had reason to know of the wrongdoing and failed to take reasonable steps to avoid further harm. I must stress that the doctrine of recklessness here bars Mr. Stephenson's recovery in every respect.

Now, the Court has not reached the question of prescription of Mr. Stephenson's Section 12 claim under the 19833 (sic) act, but I would note for the record that that

claim is prescribed by a statute of limitations or prescription period of one year. And were it necessary to reach that question, I would indeed hold that all claims after May 11, 1983, would be barred as to the remaining 1933 act claim because Mr. Stephenson knew or should have known prior to May 11, 1983, that something was wrong, and yet I believe this suit was filed in May of 1984 or something thereafter.

The plaintiff regularly received confirmation slips and monthly statements that, again, as I stressed, set forth everything. He discovered or should have discovered the alleged wrongdoing. I want to stress that I do not reach that issue, but had I been required to reach that issue I would have dismissed the 1933 act claim prior to May 11, 1983. Accordingly, for all of the reasons stated, the complaint is dismissed pursuant to Rule 41(b). Judgement is hereby rendered for the defendants and against the

plaintiff, each party to bear their own costs. Court is adjourned.